STATE AND LOCAL FINANCE IN THE POSTWAR PLANS OF THE SOUTH

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Along with their sister states in other parts of the country, all of the states of the South have established postwar planning agencies to stimulate, aid and co-ordinate postwar preparation and planning by public and private groups within their respective jurisdictions. Aside from their promotional and co-ordinating functions, the chief task of the state planning agency is to determine what governmental measures will best support and implement the efforts of private industry to supply adequate opportunities for employment and a high level of income in the peacetime years to come.

Among the governmental measures which will exercise a powerful influence in advancing or retarding the economic development of particular states, it is generally recognized that state and local enactments in the sphere of taxation, borrowing and spending will play a prominent rôle. A number of state planning agencies have, accordingly, set up sub-committees on postwar taxation and fiscal policy. Committees of this nature are responsible for conducting studies and investigations relative to the economic effects of existing state and local fiscal legislation. Beyond this, they are charged with the responsibility of recommending postwar programs of public expenditure and taxation which will positively promote the expansion of private productive activity within the state.

In framing fiscal policies which will be conducive to full employment and a high level of income, most of the states of the Southeast are faced by certain unique difficulties which are not normally present in other parts of the country. These difficulties have their origin in the age distribution of the southern population, in the relative level of per capita income, and in the peculiar need of the South for a more profitable balance between agriculture and industry. It is the purpose of this article to describe the nature of these difficulties and to point out their implications for state and local finance. It is also proposed to consider what particular postwar fiscal policies are appropriate for the southeastern states in view of their special situation.

In formulating postwar fiscal policies for the Southeast, it is necessary to begin with a clear realization of one basic fact. The southeastern states have relatively more children of school age than any other part of the nation. In the United States as a whole, there are on an average 36 children of school age (5 to 17 years) for every 100 persons of working age (18 to 64 years). The composite average for the eleven southeastern states is approximately 47 children of school age for every 100 persons of working age. In North and South Carolina, and Mississippi, the ratio of school children is above 50 per hundred. In Virginia, Georgia, Kentucky, Tennessee, the ratio is above 43 per hundred. Florida with a ratio of 36 children per hundred persons of working age is the only state of the Southeast which approximates the national average.

The South's abundance of children constitutes its richest potential asset. To convert this potential asset into an actual one, however, it is necessary that the children be adequately trained in the ways of modern economic life. This requires good public schools, and public schools involve taxation. For the United States as a whole, public education accounts for about 30 per cent of all state and local taxes, exclusive of gasoline and motor vehicle license taxes and contributions to unemployment compensation funds.[1] In the South, the proportion of state and local tax funds budgeted for education is in general considerably higher. Thus the tax funds expended on education in North Carolina in recent years reach a sum which is very close to half of the combined total of all local tax collection plus the tax receipts of the state general fund.

Even if the wealth and income of the people of the southeastern states were equal to the national average, they would have to tax themselves from 20 to 50 per cent more severely in order to maintain the average national standard of school expenditure per pupil. This is because relative to their working population they have from 20 to 50 per cent more children to educate. Moreover, unlike certain northern states, the educational responsibility of the southern states is not reduced by substantial enrollments in parochial schools.

TABLE I

CHILDREN OF SCHOOL AGE (5–17 YEARS) PER 100 PERSONS OF WORKING AGE (18–64 YEARS): 1940*

Average entire United States			36.1
Average Southeast			46.7
South Carolina	53.8	Ohio	32.9
North Carolina	51.0	Massachusetts	32.0
Mississippi	50.6	Delaware	31.8
Alabama	49.9	Minnesota	31.6
Arkansas	47.6	Connecticut	30.6
Kentucky	46.8	New Jersey	30.0
Georgia	46.1	Illinois	29.8
Tennessee	44.3	Oregon	29.4
Louisiana	43.9	Washington	28.8
Virginia	43.3	New York	28.5
Florida	35.5	Nevada	28.0

* Source: U. S. Bureau of the Census, 16th Census, 1940.

The fact that the average level of wealth and income of the people of the South is below the average for the nation as a whole operates further to increase the relative weight of taxation required to support any given standard of educational service. As will be seen, from the following table, in two of the eleven states of the Southeast, average income payments per inhabitant of working age are below 55 per cent of the corresponding national average; in eight states they are below 70 per cent of that average, and in no southeastern state do they exceed 85 per cent of the average national level.

[1] U. S. Department of Commerce, Bureau of the Census, *Financing Federal, State and Local Governments*, 1941, p. 52.

The smaller the amount of taxable wealth and income in an area, the higher will be the rate of taxation required to raise a given sum. Since the taxable resources of the southeastern states are from 15 to 45 per cent below the national average, they must tax themselves from 20 to 80 per cent more severely than the average to maintain the national average of school expenditure per pupil. This circumstance would be serious enough if the southeastern states had merely an average size school population to educate. As has already been indicated, however, all of the southeastern states except Florida have school populations which in relative size are from 20 to 50 per cent above the national norm. The South's deviation from the national average as to income, reinforced by its deviation as to the relative size of its school population, has this important fiscal consequence: to maintain educational services on a par with the national average for all of their children, the southeastern states must levy taxes at rates from 16 to 165 per cent higher than the average rate required to maintain the same services in the country as a whole.

TABLE II

*Income Payments per Inhabitant of Working Age, 1943**

	AMOUNT	PER CENT OF NATIONAL AVERAGE
Entire United States	$1,647	100.0
Southeastern States	1,130	68.6
Alabama	1,067	64.8
Arkansas	895	54.3
Florida	1,392	84.5
Georgia	1,114	67.6
Kentucky	1,074	65.2
Louisiana	1,206	73.2
Mississippi	869	52.8
North Carolina	1,099	66.7
South Carolina	1,047	63.6
Tennessee	1,106	67.2
Virginia	1,380	83.8

* Based on Schwartz, Chas. F., "State Income Payments, in 1943," *Survey of Current Business*, August 1944, p. 12.

Can the states of the Southeast levy taxes at rates considerably above the average for the country as a whole without seriously checking their industrial growth and perpetuating the low income which is the chief cause of their fiscal difficulties? It is generally recognized that the South's high proportion of children as well as its relatively low per capita income is closely connected with the high proportion of its population which is engaged in agricultural pursuits. Over 150 years ago, Adam Smith, in his *Wealth of Nations*, observed that in every country of Europe there were a hundred people who had acquired great fortunes by trade and manufactures for one who had done so through the culti-

vation of the land. This observation might be made with equal accuracy of the United States today.

For the country as a whole, agriculture yields a return per worker employed which is less than half as great as the return per worker in manufacturing. Only 16 per cent of the total employed population of the United States, however, depends on agriculture for a livelihood. As will be seen from Table III, in every state of the Southeast, except Florida and Virginia, from a fifth to a half of the employed population is engaged in agriculture. Moreover, the income advan-

TABLE III

INCOME PER PERSON EMPLOYED OR SEEKING EMPLOYMENT IN MANUFACTURING AND AGRICULTURE, 1940*

AREA	PER CENT OF TOTAL EMPLOYED OR SEEKING EMPLOYMENT IN		AVERAGE INCOME PER PERSON EMPLOYED OR SEEKING EMPLOYMENT IN	
	Manufacturing	Agriculture	Manufacturing	Agriculture
United States	24.9	16.4	$1,373	$676
Southeast	18.3	30.0	855	440
Alabama	18.9	32.8	894	356
Arkansas	10.7	45.9	691	462
Florida	11.9	15.7	775	619
Georgia	19.9	28.5	767	409
Kentucky	12.8	30.7	997	459
Louisiana	13.8	27.3	981	402
Mississippi	10.9	49.5	641	417
North Carolina	28.8	28.2	840	494
South Carolina	25.2	31.9	772	431
Tennessee	19.2	28.4	953	397
Virginia	20.6	21.1	937	508

* Source: Data on number of persons employed or seeking employment from *Sixteenth Census of the United States*, 1940, Population, Vol. III. The Labor Force, Part 1, Table 78 and Part 2, Table 19. Unpaid family workers excluded. Income data from United States Department of Commerce, *Gross Salaries and Wages and Net Entrepreneurial Income, by Major Industry Groups and by States*, 1929–41, Mimeographed Tabulation.

tage which manufacturing has over agriculture is very little less for the Southeast than for the country as a whole.

It would be a mistake to conclude from the crude overall averages which have just been cited that any kind of manufacturing is more profitable than every kind of agriculture. As is well known, many types of agriculture are more profitable than certain existing types of industry. Still less would it be justifiable to conclude that the South should abandon farming. Agriculture is an indispensable activity, and the Southeast has rich agricultural resources. It is probably true, however, that the Southeast has too many people engaged in agricultural pursuits of low productivity and that the economic position of these people would be vastly improved if they could find jobs in southern industry at

prevailing southern wages. Such an eventuality would benefit southern agriculture as well, since it would increase the local demand for farm products.

In the ten years preceding the present war, manufacturing employment expanded at a faster rate in the Southeast than in any other section of the country. The prewar rate of expansion must be continued and, if possible, accelerated in the postwar period. The question is how can new industry be attracted to the South, and what influence will fiscal policies have in speeding or retarding industrial growth?

Among the factors which determine the location of industries, taxation is not ordinarily placed at the top of the list. Other factors, such as accessibility to raw materials and markets, the availability of an adequate supply of suitable labor, power, transportation and similar items generally carry more weight. Marked advantages with respect to these latter factors may more than offset a considerable disadvantage on the score of taxation. But when states are competing for the same industries, and when all other locational factors are in substantial balance, taxation may well be the factor which finally tips the scale in determining whether a concern will pass up one state to locate in another. The imposition of higher than average taxes on business concerns which are relatively mobile and footloose would, therefore, seem to represent a risky policy for states which are seeking new industries.

The southeastern states are thus confronted with what seems to be a dilemma. To capitalize on their richest resource, their youth, they must seek to maintain educational services which approximate the average standard for the country as a whole. But this involves taxation at higher than average rates and they cannot subject the more mobile elements of industry to such differential taxation without jeopardizing their economic growth. The choice would, accordingly, seem to lie between inadequate educational services on the one hand or arrested industrial development on the other. To devise fiscal policies which will avoid both horns of this dilemma is the difficult assignment which has been handed over to the postwar planning agencies of the Southeast.

It would be the extreme of brashness for any one individual to presume to lay down directives on postwar fiscal policy for the southeastern states. Sound policies must be based on objective investigation of the conditions prevailing in each particular state. Workable policies must embody the experience and wisdom of many different minds. There are, however, certain alternative courses of action both as regards public expenditure and as regards taxation which are open to all of the southeastern states. It is proposed here to review some of these alternatives and to comment briefly on their respective merits.

As far as public expenditure is concerned, the alternatives to be considered may be limited to expenditure for education, since education is by far the most expensive service supported from general state and local taxes. There are individuals of unquestioned devotion to the public welfare who sincerely believe that the southeastern states should cut their educational garment to fit their financial cloth; or, in other words, that they should limit their expenditure for education to such sums as can be raised without imposing a greater than average

burden of taxation on persons, property, and business within their jurisdictions. For reasons which have already been pointed out, the adoption of this policy would mean that per pupil expenditures for education in the Southeast would range from 38 per cent to 86 per cent of the national average, depending on the relative number of children and the level of wealth and income in each state. As will be seen from Table IV, in five of the eleven southeastern states, school expenditures per pupil would be less than half of the national average and only three states would be able to maintain a scale of expenditure above 60 per cent of the national average.

Many of the great men who have made signal contributions to the welfare of our nation have come from families which were rich in children but poor in goods. Few of these men would ever have had an opportunity to develop their talents,

TABLE IV

MAXIMUM POSSIBLE SCHOOL EXPENDITURE PER PUPIL EXPRESSED AS A PERCENTAGE OF AVERAGE PER PUPIL EXPENDITURE FOR THE ENTIRE NATION, IF SCHOOL TAXES IN SPECIFIED STATES WERE MAINTAINED AT AVERAGE NATIONAL LEVEL

	PER PUPIL EXPENDITURE AS PER CENT OF NATIONAL AVERAGE
All Southeastern States	53.0
Alabama	47.0
Arkansas	41.2
Florida	86.0
Georgia	52.9
Kentucky	50.3
Louisiana	60.2
Mississippi	37.7
North Carolina	47.2
South Carolina	42.6
Tennessee	54.8
Virginia	69.9

if their parents had not been willing to make more than an average effort to provide them with schooling. If the sacrifices of individual parents for the education of their children are regarded as sound investments, does it follow that it will be equally sound from the standpoint of the long-run economic progress of the Southeast for the taxpayers of this area to make more than an average effort in order to provide their youth with educational advantages on a par with those available to the youth of other areas? This is a question which our post-war fiscal planners must squarely face and answer.

There are those who believe that the only adequate solution for the problem of school finance, not merely in the Southeast, but in all other predominantly agricultural areas of the country, is Federal aid for education. Strong arguments may be marshalled in favor of this point of view. In raising and training future citizens, the people of the southeastern states are performing a valuable service for the country as a whole. The disproportionately large contribution of the

South to the nation's armed forces provides a striking instance of the value of this service.

But this is only part of the story. Very few of our large cities are rearing enough children to maintain their present populations without continuous replacements from the rural areas. About 60 per cent of the people of all ages who left the farm during the ten years ending in 1930 came from farms located south of the Mason and Dixon line. Many of the young people who will constitute the future population of our metropolitan centers in all parts of the United States are now receiving their training in the public schools of the Southeast. Since the Southeast is educating children for the benefit of the entire nation, it would seem just and proper that the entire nation bear its fair share of the cost.

Those who reject Federal aid but who nevertheless wish to provide the youth of the Southeast with educational services reasonably in line with national standards have one remaining alternative—deliberate acceptance of a higher than average burden of school taxation. This is the policy which most of the states of the Southeast have actually been pursuing. Thus, according to President Roosevelt's Advisory Committee on Education, all of the states in this area except two taxed themselves more severely than the average in order to support their schools in 1935.[2]

Consideration of the various expenditure policies which the states of this area might conceivably adopt leads back inevitably to the apparent dilemma to which attention has already been directed. Can the states of the Southeast tax themselves more heavily than the states which are competing with them for new industries without seriously retarding their economic growth? It is the main thesis of the present article that this feat can be accomplished successfully provided only that the proper taxes are selected to carry the additional burden.

The extant varieties of state and local taxes are numerous and diverse. For the present purpose, however, they may be divided roughly into two general classes. First, there are the taxes which increase the cost of doing business or which reduce business profits. All such taxes may be called business taxes for short. Second, there are the taxes which are paid directly by individuals out of their personal wealth or income. These may be called personal taxes. Included in the class of business taxes are corporation income and franchise taxes, business license taxes and sales taxes of all sorts. The two most common personal taxes are the individual income tax and the inheritance tax. The general property tax is a hybrid. In so far as it is paid by farmers and business concerns on productive property, it is a business tax. In so far as it is paid by individuals on their homes, durable consumer goods and intangibles, it is a personal tax.

From the standpoint of their potential influence on the economic growth cf a state, business taxes are by no means alike. From this point of view, two types of business taxes must be sharply distinguished: (1) taxes on concerns which are subject to interstate competition and (2) taxes on concerns which are comparatively unaffected by such competition. Business concerns selling products

[2] The Advisory Committee on Education, *The Federal Government and Education*, p. 13.

in markets which extend beyond the borders of their state are ordinarily subject to interstate competition, unless they are exploiting resources of which the state has a monopoly. Most kinds of manufacturing, wholesale trade, and certain kinds of agriculture and mining are subject to interstate competition to a relatively high degree. The particular varieties of state and local taxes which bear most heavily on competitive enterprises of the above type are the general property tax, corporation income and franchise taxes, and sales taxes which apply to the cost of raw materials and supplies.

Enterprises which produce commodities and services for nearby markets within the state, as well as interstate businesses which exploit scarce natural resources, are affected by interstate competition to a negligible extent. Representative of these categories of business are most types of retail merchandizing, personal service and amusement enterprises, public utilities to the extent that they serve residential users, and certain types of extractive industries. Among the business taxes whose application is for the most part limited to enterprises not subject to interstate competition are retail sales taxes, consumer excise taxes on liquor, tobacco, soft drinks and amusements, taxes on the residential users of public utilities, and severance taxes on the removal of scarce natural resources from the soil.

Personal taxes must likewise be distinguished according to whether they hit footloose individuals who are in a position readily to change their state of residence, or individuals who are bound to their state by strong economic ties. Individuals who derive the bulk of their income from investments may be influenced in their choice of domicile by interstate differences in rates of income and inheritance taxation or by the presence or absence of a tax on intangibles. On the other hand, persons who are tied to a state by a business or a job are not likely to change their residence because of high personal taxes.

A state which wishes to encourage industrial expansion cannot afford to tax classes of business subject to interstate competition at higher than the prevailing competitive rates. Moreover, if it wishes to become a haven for retired capitalists, it cannot afford to have abnormally high taxes on large incomes and inheritances, nor treat intangibles less favorably than neighboring states. This still leaves a large range of taxes which are capable of carrying a heavier than average load with no adverse effects on the economic growth of the state. Among the more productive of these extra-burden bearers may be mentioned the retail sales tax; the personal income tax on low and middle bracket incomes; consumers' excise taxes on liquor, tobacco, soft drinks, and admissions; public utility and insurance premium taxes; and in the case of certain states, petroleum and other severance taxes.

The general policy of taxation which is here suggested for the southeastern states involves extensive reliance on taxes which hit mass consumption and relatively high rates of personal income taxation on low and middle bracket incomes. This will doubtless invite the criticism that the proposed program violates the canon of taxation according to ability, in being unduly solicitous of interstate business and invested wealth and not sufficiently considerate of the

poor. The equity of any policy, however, can be judged only in the light of the available alternatives and as far as the present issue is concerned, the available alternatives are unmistakably clear.

In the absence of Federal aid, the southeastern states are compelled to choose between inadequate educational services, on the one hand, and heavier than average taxation on the other. If they choose inadequate educational services, they will fail to capitalize on their most valuable economic asset, their youth, and will deprive hundreds of thousands of young southerners of the opportunity to develop their productive talents. If they choose heavier than average taxation, they cannot impose the additional burden on enterprises subject to out-of-state competition without causing such enterprises either to lose business, which will reduce the number of available jobs, or to make compensating reductions in wages and other costs.

In the final analysis, the choice of the people of the southeastern states would seem to boil down to this: comparatively heavy taxes on consumption and on low and middle incomes, or acceptance of the less obvious but infinitely harsher taxes represented by ignorance, low wages and lack of job opportunities.